with cable operators that are subject to Title VI. The reason: DBS providers do not offer cable service over a "cable system" and therefore are not a "cable operator" subject to the Title VI. 47 U.S.C. §§522 (5) & (7). The same would be true, of course, with respect to non-cable competitors of cable modem service. [25]

Another argument that pervades some "cable service" opponents' comments is the claim that the Commission's general Title I ancillary authority is a better choice for regulating cable modem service because Title I is more "supple" and "flexible" than Title VI (or Title II) and would better enable the Commission to sweep away state and local regulation and to establish a "uniform, nationwide policy" with respect to cable modem service.[26] This argument is fatally flawed in two critical respects.

First, because cable modem service is a "cable service," Title VI applies to it. The Commission cannot use its general Title I authority to trump the specifically applicable requirements of Title VI (or, for that matter, any other Title of the Act).[27] Otherwise, the

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[25] SBC/BellSouth is not alone among telecommunications industry commenters in its ignorance of the substance of Title VI. CompTel, for instance, speaks (at i & 6) of "*de jure*" exclusive cable franchises, apparently unaware that exclusive cable franchises are prohibited by law. *See* 47 U.S.C. §541 (a)(1). Perhaps this Title VI blindness helps explain the telecommunications industry's disappointing failure to fulfill its 1996 Act promise to Congress that it would compete against incumbent cable operators in the multichannel video service market.

[26] *See, e.g.*, CompTel Comments at 33; New Hampshire ISP Assn. Comments at 1; OpenNet Comments at 15-16.

We note that Cox (at ii-iii, 26, 28 & 42-43) curiously makes this Title I policy argument as well, even though Cox also simultaneously claims (at i & 26) -- albeit with much less vigor -- that cable modem service is a "cable service." Given Cox's recent decision to stop paying cable franchise fees on cable modem service, Cox's apparent inconsistency would appear to be a rather transparent and self-serving effort at "heads I win, tails you lose."

[27] *See* NCTA Comments at 35.

Commission would have the authority to write all of the Titles other than Title I out of the Act. If Congress' will is to have primacy over the Commission's (as it must), such an open-ended, Title-swallowing construction of Title I cannot stand.

Second, contrary to the suggestions of these Title I "national policy" fanatics, Title VI is itself a comprehensive "national policy concerning cable communications." 47 U.S.C. §521(1). Because cable modem service is a "cable service," there is indeed a "national policy" applicable to it -- the one chosen by Congress in Title VI, not one crafted out of whole cloth under the unilluminating, generalized rubric of Title I. That some commenters may prefer a different national policy for cable modem service is irrelevant. If a different national policy is desired, only Congress, not the Commission, can craft it.

C. ILEC Pleas for "Regulatory Parity" Do Not Detract from the Conclusion That Cable Modem Service Is A "Cable Service."

Although not directed exclusively at attacking the "cable service" classification of cable modem service, another common argument made in the comments, primarily by ILECs, is a plea for "regulatory parity" and "competitive neutrality."[28] The problems with this argument are threefold.

First, while these commenters clearly wish otherwise, the Act still contains separate Titles and, as a result, explicitly prevents such "regulatory parity" in many cases.

[28] *See, e.g.*; CenturyTel Comments at 2; OPASTCO Comments at 2; Qwest Comments at 1 & 3; SBC/BellSouth Comments at i-ii & 12; USTA Comments at 7-8; Verizon Comments at 2 & 22.

Examples abound. Television broadcasters compete with cable operators, yet they must be regulated under different Titles. The same is true with respect to DBS and MMDS providers, on the one hand, and cable operators on the other. And the same is also true of wireline telecommunications service providers, on the one hand, and wireless telecommunications service providers on the other.

Second, even if ILECs' "regulatory parity" proposals were adopted, they would not result in regulatory parity. They would instead create new regulatory disparities, albeit ones these commenters apparently see as beneficial to them. The comments leave no doubt that many of the services that are or will be offered over DSL and cable modem service -- video streaming, interactive television, and "standard television quality video"[29] -- will compete with traditional cable video programming services currently subject to Title VI. Thus, if cable modem services were exported either to Title I or Title II, a new regulatory disparity (and consequent lack of "competitive neutrality") would be spawned: Cable modem service would be regulated differently than many of the traditional cable services with which it competes.

In fact, at least as the Communications Act is currently structured, "regulatory parity" across Titles of the Act is a chimera. Under whatever Title of the Act cable modem service is classified, some degree of regulatory disparity is inevitable. It is for that reason that the Commission should adhere to the statutory language and legislative history of the Act to answer the regulatory classification question. And as we have

[29] *E.g.*, TIA Comments at 9-10; Competitive Access Coalition Comments at 58; OpenNet Comments at 8.

shown, those sources clearly point to the conclusion that cable modem service is a "cable service."

A third point that ILEC "regulatory parity" proponents overlook is that much of the regulatory disparity about which they complain is, in many respects, more apparent than real. And to the extent it exists, it serves useful public policy goals.

As an initial matter, ILECs ignore the fact that, at least with respect to cable modem services, the Act provides them with the keys to escape the jail of regulatory disparity that they perceive: The 1996 amendments allow ILECs to become cable operators and to provide "cable service" under Title VI or, alternatively, through open video systems if they wish. *See* 47 U.S.C. §§571 (a)(3)(A) & (B). To be sure, unlike the case with DSL, ILECs may have to make the investment necessary to replace their legacy copper-wire pair residential networks to do that, but the resulting expansion of residential broadband capacity would be a positive development from the standpoint of competitive policy and consumer choice. In any event, given ILECs' near unanimous failure to follow through on their promises to Congress that, if the 1996 Act were passed, they would enter the multichannel video service market to compete with incumbent cable operators, the Commission should have little sympathy for ILEC complaints about regulatory disparity.

Moreover, that the Act sanctions the possibility of side-by-side competition between providers subject to different Titles of the Act is not, as the ILECs' claim, necessarily reflective of the Act's obsolescence or of unsound policy. To the contrary, inter-Title competition can and does offer significant public policy benefits.

Preservation of the Title II "common carrier" model, at least for a time, to compete side-by-side with non-common carrier broadband access models serves as an important check, or safety net, in an embryonic arena like broadband Internet access, where rosy predictions of future competition are premature and uncertain at best. Indeed, ILEC commenters inadvertently underscore the wisdom of the Act's preservation of inter-Title competition. ILEC commenters almost uniformly argue that, because cable modem service competes with their DSL offerings and enjoys substantially greater market share than DSL, ILEC DSL offerings should be completely deregulated -- either through forbearance of Title II obligations with respect to DSL, or by treating DSL as a Title I "information service."[30]

In other words, ILECs would seem to prefer a world where *no one* has the Title II obligation to make broadband access service universally available to all and on fair and non-discriminatory terms. Given the possibility that broadband may eventually supplant the public switched network as the primary means for persons to communicate with one another, the City Coalition suggests that completely abandoning the time-honored and time-tested common carrier model with respect to broadband in the speculative hope that competition may eventually make it unnecessary in the future is a reckless, dangerous policy. In any event, it certainly would be radical departure from over a century of communications policy in this nation, and we believe that the Act gives only Congress,

[30] *See, e.g.*, Century Tel Comments at 1 & 6; Qwest Comments at 3; SBC/BellSouth Comments at iii & 12; USTA Comments at 8; Verizon Comments at 3 & 22.

not an unelected Commission, the authority to make such a fundamental change in national policy.

D. Commenters' Reliance on *Broward County* Is Misplaced.

At least one ILEC and a few cable operators rely on the recent *Broward County* decision[31] for the proposition that regulation of their high-speed broadband offerings would violate the First Amendment.[32] Their reliance is misplaced.

As an initial matter, *Broward County* is inherently suspect because, by leap-frogging past the statutory issues to address the First Amendment issues, the court flagrantly violated the longstanding bedrock principle that courts should not address constitutional issues without first addressing underlying statutory issues.[33] Moreover, *Broward County* rests on a gross misreading of *Turner Broadcasting System v. FCC*, 512 U.S. 622 (1994). Contrary to the *Broward County* court's claim, the Supreme Court in *Turner* did *not* hold that cable operators are subject to the same First Amendment standards as the print media.[34] Further, *Broward County* turns *Turner* on its head: *Turner* upheld the must-carry rules against First Amendment challenge, even though the local broadcaster-beneficiaries of must-carry, unlike unaffiliated ISPs, have their own

[31] *Comcast Cablevision of Broward County v. Broward County*, No. 99-6934-Civ (S.D. Fla. filed Nov. 8, 2000)("*Broward County*").

[32] *E.g.*, Verizon Comments at 35-39; NCTA Comments at 38; AT&T Comments at 11; Cablevision Systems Comments at 15; Charter Comments at v; Comcast Comments at 26-27.

[33] *E.g., Ashwander v. TVA*, 297 U.S. 288 (1936); *Bell Atlantic v. Prince George's County*, 212 F. 3d 863 (4th Cir. 2000).

[34] *See Turner*, 512 U.S. at 657; Consumers Union Comments at 7.

local broadcast transmission facilities to circumvent the cable system bottleneck. Unaffiliated ISPs wishing to provide broadband content, in contrast, have no such route to bypass the cable system bottleneck. And given cable operators' current broadband access market share and the technological and cost shortcomings of competing delivery systems,[35] cable's bottleneck position in broadband access is in many respects far more pervasive than cable's bottleneck over local broadcasters.

Verizon's reliance on *Broward County* is even more perplexing, since it is flatly inconsistent with Verizon's position that cable modem service is not a "cable service." Aside from its dubious First Amendment analysis, one conclusion about *Broward County* seems clear: Its logic makes absolutely no sense at all unless cable modem service is a "cable service." If *Broward County*'s expansive reasoning were applied to telecommunications services, as Verizon suggests, that would mean that Title II -- and indeed all state common carrier regulation of telecommunications service providers as well -- violates the First Amendment. After all, under the *Broward County* court's reasoning, every telecommunications service provider could (but for its common carrier obligation) choose to exercise its supposed First Amendment right to refuse to carry the messages of those with whom it disagrees, or to insert preemptory messages containing its own political views to drown out or replace its customers' messages. As far as we are aware, however, no court has held that the First Amendment exterminates the application

[35] *See, e.g.*, Cable & Wireless Comments at 7-10.

of common carrier principles to telecommunications service. Certainly no precedent cited by Verizon or by *Broward County* so holds.

E. Interactive Television Is Clearly A "Cable Service."

While virtually all cable operators agree with us that cable modem service is a "cable service," a few suggest that it is premature to classify interactive television and other "potential services that may develop that make use of a combination Internet and television broadcast platform."[36] The City Coalition suggests that, while it may not be possible to foresee, much less classify, all future services provided over the cable modem platform, it certainly *is* possible to classify interactive television and any future services "that make use of a combination Internet and television broadcast platform." Any such services would easily qualify as a "cable service."

Interactive television and any other service involving a combination with the television broadcast platform would seem to qualify doubly as a "cable service": Those services would not only entail subscriber interaction with or use of "other programming service" under Section 522 (6)(A)(ii), but also would often involve subscriber interaction with or use of "video programming" under Section 522(6)(A)(i) as well. In fact, the legislative history of the 1996 amendment of the "cable service" definition makes plain that one of the specific purposes of the 1996 amendment was to include interactive

[36] AT&T Comments at 32-36 & 100 (quoting *NOI* at ¶49). *See also* NCTA Comments at 67.

television within the "cable service" definition.[37] If, as the cable industry argues (and we wholeheartedly agree), cable modem service is a "cable service," then interactive television offered over a cable system must be as well.

III. THE COMMISSION NEEDS TO ACT IMMEDIATELY AND DECISIVELY TO ELIMINATE THE INCONSISTENCY AND UNCERTAINTY CREATED BY THE *PORTLAND* AND *GULF POWER* DECISIONS.

Despite their divergence on many issues, the opening comments reveal rather widespread agreement on one point: The Commission needs to take decisive and prompt action to eliminate the inconsistency and ambiguity created by *Portland*, *Gulf Power*, and other conflicting precedent on the proper regulatory status of cable modem service.[38] The uncertainty spawned by this conflicting precedent ill serves the interests of industry, local governments, the Commission, or the public. We will leave to industry the discussion of the adverse effects of regulatory uncertainly upon it. For local governments, the looming consequences of these conflicting precedents are adverse, financial and immediate.

As the Commission is aware, Cox has announced that in the wake of *Portland*, it will cease paying local governments cable franchise fees on cable modem service in the Ninth Circuit.[39] Since opening comments were filed in this proceeding, the problem has spread. In its December 1 comments in this proceeding, AT&T dismissed *Portland*'s

[37] *See* City Coalition Comments at 6-7.

[38] *See, e.g*, AT&T Comments at 4; NCTA Comments at 41; Earthlink Comments at I; OpenNet Comments at 3; USTA Comments 3; City Coalition Comments at 3.

[39] *See, e.g.*, City Coalition Comments at 12 n. 17.

holding that cable modem service is not a "cable service" as mere "dictum,"[40] and further represented to the Commission that it believed local franchising authorities "have the authority under [§47 U.S.C. §542] to charge a franchise fee on cable operators' gross revenues, including their cable Internet services" and that "AT&T currently pays franchising fees assessed on revenues from its cable Internet services."[41]

Notwithstanding these representations, less than three weeks after it filed its December 1 comments, AT&T sent letters to all of its franchising authorities in the Ninth Circuit informing them that due to *Portland,* it planned to stop paying franchise fees on cable modem service unless those franchising authorities agreed to indemnify AT&T from any liability arising from AT&T's payment of those fees.[42] AT&T's about-face on the matter is, to say the least, perplexing, but it underscores the desperate need for the Commission to step forward and establish once and for all the proper regulatory classification of cable modem service.

In its recent *amicus* briefs in both the Ninth Circuit *Portland* and Fourth Circuit *Henrico* appeals, the Commission took the position that it was the body charged by Congress with implementing federal communications policy but that it had not yet decided the proper regulatory classification of cable modem service. If the Commission is to fulfill its obligations as the body responsible for construing the Act in a uniform way

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[40] AT&T Comments at 4.

[41] *Id.* at 31.

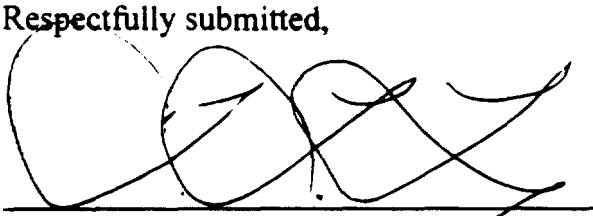
[42] Copies of sample letters from AT&T, and franchising authorities' responses, are included in Attachment A to these reply comments.

to implement national communications policy, then it is incumbent on the Commission to resolve the proper regulatory classification of cable modem service, and to do so immediately. We therefore strongly urge the Commission promptly to initiate and complete a rulemaking proceeding to classify cable modem service as a "cable service" within the meaning of 47 U.S.C. §522(6).

CONCLUSION

For the foregoing reasons, and these set forth in our opening comments, the City Coalition urges the Commission promptly to institute a rulemaking proceeding to classify cable modem service as a "cable service" subject to Title VI. Alternatively, if the Commission were to conclude otherwise (wrongly, we believe), then the Commission should require cable operators to provide third-party ISPs with access to operators' cable modem platforms pursuant to the full open access requirements of Title II.

Respectfully submitted,



Tillman L. Lay

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1900 K Street, N.W., Suite 1150
Washington, DC 20006
(202) 429-5575

Counsel for the City Coalition

Dated: January 10, 2001
WALIB:89551.1\114490-00001

ATTACHMENT A

Via facsimile and US Mail

December 15, 2000

Janet Freeland
Senior Financial Analyst
Real Property Division
City of Palo Alto
250 Hamilton Avenue
Palo Alto, CA 94301

Re: Franchise Fees on @Home

Dear Janet:

I am writing regarding the assessment of franchise fees on revenue derived from the provision of cable modem service (currently AT&T @Home). As you know, we have been providing cable modem service to subscribers as a cable service and paying the City of Palo Alto (and its member JPA communities) a 5% franchise fee on that revenue (which fee we pass through to subscribers as authorized under federal law). Under the Ninth Circuit Court of Appeal's recent decision in AT&T v. City of Portland,[1] it appears that the Ninth Circuit Court does not consider this to be a "cable service." Thus, at least in the Ninth Circuit, there is a serious question as to whether local franchising authorities have the right to assess cable service franchise fees on cable modem service revenue.

Currently, the Federal Communications Commission ("FCC") has a proceeding underway which may ultimately help resolve this issue.[2] In addition, there is other pending litigation, and courts outside this Circuit have rendered opinions that might lead to a conclusion different from the apparent conclusions in the Portland decision. Nonetheless, in light of the Portland decision, there is some risk that the City of Palo Alto would be exposed to potential refund liability in the future, should it continue to assess franchise fees on cable modem service revenue. At least one local government has determined to eliminate this risk by waiving the franchise fee on cable modem service at this time. Other local governments, while continuing to assess the fees, have decided to deposit them into an escrow type account so that such fees will be available for refund at such time as a court of competent jurisdiction or the FCC determines whether a refund is necessary.

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[1] 216 F.3d 871 (9th Cir. June 22, 2000).

[2] Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities, Notice of Inquiry, FCC 00-355 (released September 28, 2000).

Given the uncertain nature of the law regarding franchise fees on cable modem service, we believe that it is in the best interests of the City of Palo Alto, as well as AT&T, to waive these franchise fees (and suspend the pass through of such fees to subscribers) while this issue remains unsettled. Suspension of franchise fees on @Home is particularly important in states within the Ninth Circuit, because of the existence of state consumer protection laws which often give rise to class action or other litigation. Such lawsuits might seek a refund of any fees not lawfully collected (which could require the City of Palo Alto to refund them to AT&T so they could be returned to consumers.) This means that the City of Palo Alto assessing the fee could become a defendant in such litigation.

In light of the above, we believe that the best course of action is for the City of Palo Alto to waive these franchise fees until there is a determinative decision. Unless we hear from you, that is how we will proceed beginning January, 2001. If, instead, the City of Palo Alto requests that franchise fees continue to be assessed on cable modem service (and passed through to subscribers), then AT&T will require that the City of Palo Alto sign an agreement acknowledging the potential refund liability and agreeing to offset AT&T's future franchise fees by the amount of any refund liability ordered, as well as AT&T's costs and reasonable attorneys fees.

If you would like to discuss this matter further, or would like further information or copies of the referenced court decisions, please feel free to contact me at 650/631-0191, Ext. 375. We would appreciate receiving a response to our request to waive the franchise fees on @Home by the end of year.

Thank you.

Sincerely,

Kathi Noe
Director, Government Affairs

City of Palo Alto
Office of the City Attorney

January 5, 2001

Ms. Kathi Noe
Director, Government Affairs
AT&T Broadband
1691 Bayport Avenue
San Carlos, CA 94070

Dear Ms. Noe:

At Janet Freeland's request, I am responding to your letter, dated December 15, 2000, concerning the assessment of franchise fees on cable modem service revenue.

In your letter, you asked the City of Palo Alto ("City"), on behalf of the Joint Powers Agency members, to waive franchise fees on cable modem service pending a final decision in the Federal Communication Commission's Notice of Inquiry proceeding, FCC Gen. Dkt. 00-185 (September 28, 2000). In the alternative, you asked the City to enter into an agreement to acknowledge AT&T Broadband's ("AT&T") potential refund liability to subscribers with respect to those fees, and agree to offset any refund liability against future franchise fees.

As outlined below, the City presently will not waive, or agree to waive, AT&T's obligation under City of Palo Alto Ordinance No. 4636 and the City's Cable Television Franchise Agreement with TCI Cablevision of California, Inc. ("TCI"), to pay franchise fees on cable modem service. It also will not effectively indemnify, or agree to indemnify, AT&T against any real or imagined refund liability or potential litigation costs.

We, of course, are willing to discuss these matters further. Before I present the two options outlined below that may address AT&T's concerns, the City would like to comment on, and seek your responses to its comments to, your letter.

P.O. Box 10250
Palo Alto, CA 94303
650.329.2171
650.329.2646 fax

A. City Comments to AT&T's letter.

1. AT&T has taken inconsistent positions on the issue of whether franchise fees may be collected on cable modem services.

As you know, in AT&T Corp. v. City of Portland, 216 F.3d 871 (9th Circuit 2000), the Ninth Circuit did not decide whether franchise fees may be collected on cable modem service. AT&T tacitly acknowledges this fact in your letter. Yet, on the basis of the relative uncertainty created by the decision, your letter nevertheless suggests that AT&T will refuse to collect these fees beginning in January 2001.

The City is puzzled by AT&T's approach and request. On the one hand, AT&T recommends that the City should take action to "waive these franchise fees" as if the Portland decision prohibits the collection of franchise fees on cable modem service. Another option, which AT&T appears to have discounted, would be for AT&T simply to maintain the status quo until a definitive decision is issued by the FCC or the courts.

On the other hand, AT&T (on the basis of its written comments filed on December 1, 2000, with the FCC in FCC Gen. Dkt. 00-185) appears to acknowledge that, Portland notwithstanding, franchise fees may be collected on cable modem service. There, AT&T stated in its comments to the FCC that cable modem service is a "cable service"; it also dismissed as mere "dictum" the Portland conclusion that cable modem service is not a "cable service" but a "telecommunications service" (at pages 4-5 and 12-19). AT&T further informed the FCC that local franchising authorities "have the authority under [47 U.S.C. §542] to charge a franchise fee on cable operators' gross revenues, including their cable Internet services," and that "AT&T currently pays franchising fees assessed on revenues from its cable Internet services" (at page 31).

Under the circumstances, the City cannot seriously entertain AT&T's request to "waive franchise fees" on cable modem service when AT&T itself (on the basis of its comments to the FCC) appears not to believe that Portland bars a cable operator from paying franchise fees on cable modem service.

2. AT&T is misinformed in its observation that its "pass through" of the franchise fee on cable modem service is authorized by federal law.

AT&T claims that it possesses the authority to "pass through" the franchise fee on cable modem service "to subscribers as authorized under federal law." The City disagrees with AT&T's interpretation of federal law on at least two grounds.

First, under Title 47, Section 76.922(f) of the Code of Federal Regulations, a "pass-through" of franchise fees over and above the maximum permitted rate only occurs with respect to the calculation of rate-regulated basic cable service rates under the FCC's rate regulation rules. Neither the FCC rules nor the Cable Act authorize or otherwise address the ability of cable operators to "pass through" franchise fees on cable modem and other rate-deregulated cable services.

It is true, of course, that 47 U.S.C. §542(e) requires cable operators to pass through to subscribers the amount of any decrease in a franchise fee. But, it says nothing about passing through any increase in franchise fees. Moreover, by definition, Section 542(e) applies only to cable franchise fees and thus would only come into play if cable modem service were indeed a "cable service." If that is so, then AT&T has no basis whatsoever to discontinue paying franchise fees on cable modem service.

Cable operators are generally free to charge whatever rates they wish for cable modem and other rate-deregulated services. Thus, they cannot claim in good faith any express authorization to "pass-through" cable franchise fees with respect to such rate-deregulated services, any more than they have any express authorization to "pass-through" any other expenses they incur for rate-deregulated services. The concept of a "pass-through" simply has no application to rate-deregulated services, where the operator is free to set a price at any level it wishes.

Second, 47 U.S.C. §542(c), which allows (but does not require) cable operators to include a line item on subscriber bills that identifies the amount of the retail price of cable service attributable to the franchise fee, does not authorize any "pass-through" of franchise fees. Itemization of franchise

exposure, real or imagined, to litigation is not a legitimate basis for AT&T's refusal to pay the required franchise fees.

The City simply cannot agree to indemnify AT&T against any potential liability for franchise fees or other costs on account of the collection of franchise fees on cable modem service, which AT&T unilaterally has chosen to itemize on subscriber bills.

B. **Options Available to AT&T.**

If AT&T is truly concerned about its potential exposure to class action litigation, then the City is willing to discuss the following options.

First, because AT&T's itemization of franchise fees is the only plausible source of the exposure about which you express concern, AT&T simply could cease itemizing franchise fees on cable modem service in subscribers' bills. After all, AT&T is not required by federal law to itemize these fees. Note, however, if AT&T refrains from itemizing franchise fees, this would not reduce the amount that AT&T can charge subscribers for cable modem service, because AT&T can set the cable modem service rates at any level it chooses.

Second, as an alternative, the City would be willing to discuss the possibility of agreeing not to collect a "cable franchise fee" from AT&T on cable modem services, provided that AT&T would be willing to agree to pay the City a separate 5% public rights-of-way fee on cable modem service. AT&T must realize that, if cable modem service is not a "cable service," then AT&T has no current right to use the City's public rights-of-way to provide that service under the Cable Television Franchise Agreement, because that agreement authorizes TCI (and AT&T) to use the City's public rights-of-way only to provide "cable service."

We presume that AT&T is not relying on any statewide franchise to provide telecommunications service under the California Public Utilities Code as a basis for using the City's public rights-of-way to provide cable modem service. As far as the City is aware, the California Public Utilities Commission has not issued to AT&T's affiliate, TCI, a certificate of public convenience and necessity to operate as a competitive local exchange carrier to provide telecommunications service. In any

fees on a bill and the "pass-through" of franchise fees to, or "collecting" franchise fees from, subscribers are separate and distinct legal concepts under federal law. The Fifth Circuit held as much in City of Dallas v. FCC, 118 F. 3d 393 (5th Cir. 1997), where it clearly noted that, even when a line item is included on a subscriber bill, franchise fees are imposed upon the cable operator, *not* on subscribers.

The City cannot seriously consider AT&T's request to "suspend franchise fees," because there is no express authorization to "pass through" a franchise fee as part of a cable modem service charge.

3. AT&T's concern with potential subscriber class action lawsuits is unfounded.

AT&T suggests that, if it were to continue to "collect" franchise fees on cable modem service, it might be exposed to class action lawsuits by subscribers seeking "a refund of any fees not lawfully collected." Though AT&T professes concern that the City also would incur refund liability, the City does not share that concern.

AT&T's position rests on the misguided notion that it "collects" franchise fees from subscribers. It does not. Rather, the franchise fee is imposed on AT&T, not subscribers; the City "collects" the franchise fee from AT&T, and AT&T only, not from subscribers. That AT&T may recover revenues from subscribers that it uses to pay the franchise fee is beside the point.

As the Dallas court recognized, franchise fees are imposed on, and paid by, AT&T, not subscribers. Therefore, AT&T does not "collect" any franchise fees from subscribers that could be refunded. Because cable modem service is rate-deregulated, AT&T may charge subscribers the same amount for cable modem service that it currently charges (inclusive of the franchise fee) whether or not AT&T paid franchise fees to the City. To the extent AT&T's concern about class action suits has credence, that concern arises solely from the manner in which AT&T voluntarily chooses to itemize franchise fees on cable modem service in subscribers' bills. While AT&T has a right to itemize if it chooses, the City bears no responsibility for the consequences of AT&T's voluntary decision to do so. Any

evant, as mentioned above, AT&T has taken the position before the FCC that cable modem service is not a "telecommunications service" and that Portland's suggestion to the contrary is non-binding "dictum." The City's position is that, if cable modem service were determined not to be a "cable service," neither the City nor the State of California has granted AT&T any authority to use the City's public rights-of-way to provide that service.

The City very much appreciates the concern for its interests expressed by AT&T. The City, however, must decline AT&T's request that it either waive the franchise fee requirement with respect to cable modem service or indemnify AT&T. Thus, until further notice, the City expects AT&T to continue paying franchise fees on cable modem revenues. In the interim, the City is ready and willing to discuss the options outlined above, namely, AT&T discontinues itemizing cable modem franchise fees, or it agrees to pay a separate 5% public rights-of-way fee on cable modem service in lieu of a "cable franchise fee" on that service.

I look forward to your prompt response.

Sincerely,

ARIEL PIERRE CALONNE
City Attorney

GRANT KOLLING
Senior Assistant City Attorney

GK:syn

cc: Carl Yeats, Director of Administrative Services
Janet Freeland, Senior Analyst
Ariel Pierre Calonne, City Attorney
Kent Lewcock, AT&T

AT&T Broadband
2697 Chad Drive
Eugene, OR 97408-7335

December 13, 2000

Pam Berrian
Franchise Manager
City of Eugene
61 West 8th 2nd Floor
Eugene, Oregon 97401

Re: Franchise Fees on AT&T @Home

Dear Ms. Berrian:

I am writing regarding the assessment of franchise fees on revenue derived from the provision of cable modem service (currently AT&T @Home). As you know, we have been providing cable modem service to subscribers as a cable service and paying the City of Eugene a 5 percent franchise fee on that revenue (which fee we pass through to subscribers as authorized under federal law). Under the Ninth Circuit Court of Appeal's recent decision in AT&T v. City of Portland,[7] it appears that the Ninth Circuit Court does not consider this to be a "cable service." Thus, at least in the Ninth Circuit, there is a serious question as to whether local franchising authorities have the right to assess cable service franchise fees on cable modem service revenue.

Currently, the Federal Communications Commission ("FCC") has a proceeding under way that may ultimately help resolve this issue.[8] In addition, there is other pending litigation, and courts outside this Circuit have rendered opinions that might lead to a conclusion different from the apparent conclusions in the Portland decision. Nonetheless, in light of the Portland decision, there is some risk that the City of Eugene would be exposed to potential refund liability in the future, should it continue to assess franchise fees on cable modem service revenue. At least one local government has determined to eliminate this risk by waiving the franchise fee on cable modem service at this time. Other local governments, while continuing to assess the fees, have decided to deposit them into an escrow type account so that such fees will be available for refund at such time as a court of competent jurisdiction or the FCC determines whether a refund is necessary.

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7 216 F.3d 871 (9th Cir. June 22, 2000).

8 Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities, Notice of Inquiry, FCC 00-355 (released September 28, 2000).

Given the uncertain nature of the law regarding franchise fees on cable modem service, we believe that it is in the best interests of the City of Eugene, as well as AT&T Broadband, to waive these franchise fees (and suspend the pass-through of such fees to subscribers) until this issue is settled. Suspension of franchise fees on AT&T @Home is particularly important in states within the Ninth Circuit, because of the existence of state consumer protection laws which often give rise to class action or other litigation. Such lawsuits might seek a refund of any fees not lawfully collected (which could require the City of Eugene to refund them to AT&T Broadband so they could be returned to consumers.) This means that the City of Eugene assessing the fee could become a defendant in such litigation.

In light of the above, we believe that the best course of action is for the City of Eugene to waive these franchise fees until there is a determinative decision. Unless we hear from you, that is how we will proceed beginning January, 2001. If, instead, the City of Eugene requests that franchise fees continue to be assessed on cable modem service (and passed through to subscribers), then AT&T Broadband will require that the City of Eugene sign an agreement acknowledging the potential refund liability and agreeing to offset AT&T Broadband's future franchise fees by the amount of any refund liability ordered, as well as AT&T Broadband's costs and reasonable attorneys fees.

If you would like to discuss this matter further, or would like further information or copies of the referenced court decisions, please feel free to contact me at 541-431-3518. We would appreciate receiving a response to our request to waive the franchise fees on AT&T @Home by the end of year.

Thank you.

Sincerely,

Sanford T. Inouye
Area Franchise Manager

City Manager's Office

City of Eugene
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Eugene, Oregon 97401-2793
(541) 682-5010
(541) 682-5414 Fax
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www.ci.eugene.or.us

January 2, 2001

Mr. Sanford Inouye
AT&T Broadband
2897 Chad Drive
Eugene, OR 97408-7335

Dear Mr. Inouye:

I am writing in response to your letter dated December 13, 2000, concerning the assessment of franchise fees on cable modem services. The City of Eugene cannot agree to waive any payment of any franchise fees and certainly will not agree to indemnify AT&T Broadband against any hypothetical costs that would not be in any way the responsibility of the City.

First and foremost, AT&T Broadband must be aware that if it unilaterally reduces its payment of franchise fees to the City of Eugene, AT&T Broadband will be in violation of its franchise agreement with Eugene. That agreement represents the only authority AT&T Broadband has to use the public right-of-way in Eugene to provide cable modem service. Your reliance on the Portland case ignores the specific language of Eugene's franchise and overlooks that the Eugene franchise is not necessarily limited to "cable services."

Eugene's franchise with AT&T Broadband permits AT&T Broadband to use its facilities to provide other types of communications services, which AT&T Broadband has specifically claimed include cable modem services. AT&T Broadband cannot have it both ways: If AT&T chooses not to pay franchise fees on cable modem service, then it cannot rely on the Eugene franchise to use public rights-of-way in Eugene to provide that service. If AT&T cannot rely on the franchise, it has no authority whatsoever to use public rights-of-way in Eugene to provide cable modem service. Your request that Eugene waive the collection of franchise fees is either a request that Eugene amend the terms of AT&T Broadband's franchise or that Eugene grant permission to AT&T Broadband to violate that franchise. Eugene is not prepared to do either. The franchise requirement is that AT&T Broadband pay a franchise fee on all of its gross revenues, meaning "any and all compensation in whatever form.....for services provided to subscribers within the franchise territory," which would include revenues from cable modem services. To that end, we believe it is now appropriate to request, per Section 10(4) of the franchise, that AT&T include with each quarterly payment, a report listing all gross revenues, by type of service provided in the franchise territory in order to affirm the franchise amounts due.

Returning to your reliance on AT&T v. City of Portland, we find that reliance particularly troubling in light of AT&T's own December 1 arguments in the FCC's NOI in General Docket No. 00-185 (at pp. 30-31): "To the extent that the Communications Act grants local franchising authorities the authority to regulate 'cable services' they would also have the authority to regulate cable Internet services. Thus, taking the example provided in Paragraph 217 of the NOI, local franchising agencies would have the authority under [47 USC Section 542] to charge a franchise fee on cable operators' gross revenues, including their cable Internet services. In fact, AT&T currently pays franchising fees assessed on revenue from its cable Internet services."

AT&T took its position to the FCC earlier this month, nearly six months after the Portland decision was rendered. We fail to see why, less than three weeks later, AT&T turns around and takes the opposite position with the City of Eugene. Moreover, AT&T itself (again in the FCC NOI proceeding) strenuously argued that cable modem service is indeed a "cable service" and claimed that language in the 9th Circuit Portland decision suggesting otherwise is mere "dictum".

Your letter speculates that if AT&T Broadband continues to pay franchise fees on cable modem service, AT&T Broadband might be exposed to class action lawsuits by subscribers seeking "a refund of any fees not lawfully collected." AT&T Broadband must be aware that it does not "collect" franchise fees from subscribers. The franchise fee is imposed on AT&T Broadband, and the fee is therefore "collected" from AT&T Broadband, not from subscribers. That AT&T Broadband *chooses* to itemize the fee on its bill to subscribers, or that AT&T Broadband might use revenues it derives from subscribers to pay the fee, does not alter those facts. Moreover, since cable modem service is rate-deregulated, AT&T Broadband can charge subscribers whatever it wishes for the service, regardless whether or not it pays franchise fees on the service. The City bears no responsibility for that AT&T decision, a decision that in no way relieves AT&T Broadband of its legal obligation to pay the franchise fees lawfully owed the City.

In conclusion, the City declines your request that it either waive the franchise fee requirement or indemnify AT&T Broadband. AT&T Broadband continues to be obligated to pay franchise fees on cable modem revenues. Our staff have always been willing to discuss these and similar issues with AT&T Broadband. Thus, I am disappointed with AT&T's decision to unilaterally demand such a concession on our part, and within such a short time-frame, especially considering there are other franchise issues on which City staff have long awaited an AT&T response, and continue to await your attention.

Sincerely,

Jim Johnson
City Manager